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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF THE
ARIZONA ELECTRIC POWER COOPERATIVE,
INC. FOR A HEARING TO DETERMINE THE
FAIR VALUE OF ITS PROPERTY FOR
RATEMAKING PURPOSES, TO FIX A JUST AND
REASONABLE RETURN THEREON AND TO
APPROVE RATES DESIGNED TO DEVELOP
SUCH RETURN

Docket No. E-01773A-12-0305

**AEPCO'S RESPONSE TO STAFF
REPORT RE ECAR PLAN OF
ADMINISTRATION AND
TARIFF**

Pursuant to the Procedural Order entered in this matter on September 19, 2014, the

Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative") submits its response
to the Utilities Division Staff Report, dated October 21, 2014.

Staff agrees that the Commission should approve AEPCO's proposed Environmental
Compliance Adjustment Rider ("ECAR") Tariff and Plan of Administration. However, Staff
recommends that AEPCO's request to recover certain chemical costs through the ECAR be
denied.

The purpose of the ECAR mechanism is to "provide recovery of potential costs
associated with future environmental compliance obligations..."¹ As the Commission knows,
the most immediate environmental compliance obligation faced by AEPCO is its ability to fund
both capital and operating expenses necessary to maintain the viability of Apache Station Units 2
and 3 in response to the EPA's Regional Haze requirements. A key element of AEPCO's

¹ Decision No. 74173, Finding 77.

1 compliance plan involves the use of chemicals, like urea, the cost of which are highly volatile.²
2 Similarly, to comply with the EPA's Mercury and Air Toxics Standards, AEPCO will need to
3 purchase activated carbon, another volatile chemical expense that should be eligible for recovery
4 through the ECAR.³ Denying AEPCO the ability to recover these costs through the ECAR will
5 have dramatic, negative impacts on the Cooperative's available working capital. It will also
6 deprive AEPCO's members of the primary benefits of the ECAR, *i.e.*, rate stability, gradualism
7 and reduced rate case frequency and expense.

8 AEPCO's chemical cost recovery request is limited to a narrowly defined category of
9 expenses that are booked to Account 502 and are appropriate for recovery through an adjustor
10 mechanism like the ECAR. Specifically, the chemical costs eligible for recovery are limited to
11 Account 502 expenses "incurred solely due to Environmental Regulation(s) but not including
12 any indirect expenses such as overhead."⁴ These costs qualify for recovery through an adjustor
13 mechanism given that (1) the need to incur the expense is not within the Cooperative's control
14 and (2) the cost is considerable, ongoing and quite volatile.

15 Staff's rationale for opposing recovery of chemical costs through the ECAR appears to
16 relate to other utility environmental surcharge mechanisms. Staff's Report points out that no
17 other environmental mechanism provides for the recovery of Account 502 expenses. However,
18 there is no explanation for the omission of these costs from other mechanisms or – more
19 importantly – whether the same rationale should apply to AEPCO's request.

21 ² The chart attached as Exhibit 1 compares the historic price of urea with natural gas. Given the similarly dramatic
22 changes in price over the years, the rationales for passing the changes in the costs of natural gas – both positive and
negative – through an adjustor mechanism applies equally to urea.

23 ³ Attached as Exhibit 2 is a summary of market forecasts regarding the increased demand for activated carbon and
its corresponding impact on price.

24 ⁴ AEPCO's Application for Approval of the ECAR Plan of Administration and Tariff, April 30, 2014, Exhibit B at
page 3, lines 2–4 (emphasis in original).

1 Importantly, AEPCO's ECAR Plan of Administration provides for additional
2 Commission oversight not included in other environmental surcharge mechanisms. Unlike the
3 adjusters approved for Tucson Electric Power Company ("TEP") and Arizona Public Service
4 Company ("APS"), the ECAR requires affirmative Commission approval of the Cooperative's
5 Environmental Compliance Strategy ("ECS") before any surcharge can be applied to member
6 bills. Therefore, if the Commission approves chemical costs as eligible for recovery through the
7 ECAR, that does not mean that those costs will automatically be recovered. Instead, the
8 Commission will have the opportunity to review and evaluate the specific costs included in
9 AEPCO's ECS and determine, based on the details of the plan, the appropriateness of allowing
10 recovery through the adjuster mechanism.⁵ Finally, we note that at least one other Arizona
11 electric utility has received Commission approval to recover similar Account 502 costs through
12 an adjuster mechanism. Last year, the Commission authorized TEP to recover Account 502 lime
13 costs through its Purchased Power and Fuel Adjustment Clause.⁶

14 For the foregoing reasons, AEPCO requests the Commission enter its Order approving
15 the ECAR Tariff and Plan of Administration, including approval to recover through it the narrow
16 category of chemical costs as described herein. In the form proposed by AEPCO, the ECAR will
17 appropriately, economically and efficiently accomplish each of the goals the Cooperative, their
18 members and the Commission and Staff intend to further by adoption of the ECAR.

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22 ⁵ *Id.*, Exhibit B at page 4, lines 11–13 and 24–27 (requiring AEPCO to submit an initial ESC and revised tariff "for
Commission approval"). In contrast, under the APS and TEP mechanisms, the environmental surcharge
automatically goes into effect unless the Commission acts to suspend the filing.

23 ⁶ Decision No. 73912 (approving Settlement Agreement, attached to Decision as Exhibit A; redline draft of PPFAC
Plan of Administration, attached as Attachment C to Settlement Agreement, at pages 2 and 10).

1 RESPECTFULLY SUBMITTED this 13th day of November, 2014.

2 GALLAGHER & KENNEDY, P.A.

3
4 By 

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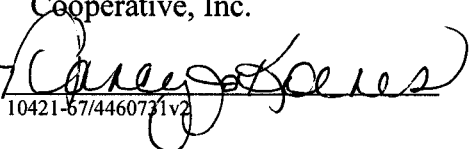
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EXHIBIT 1

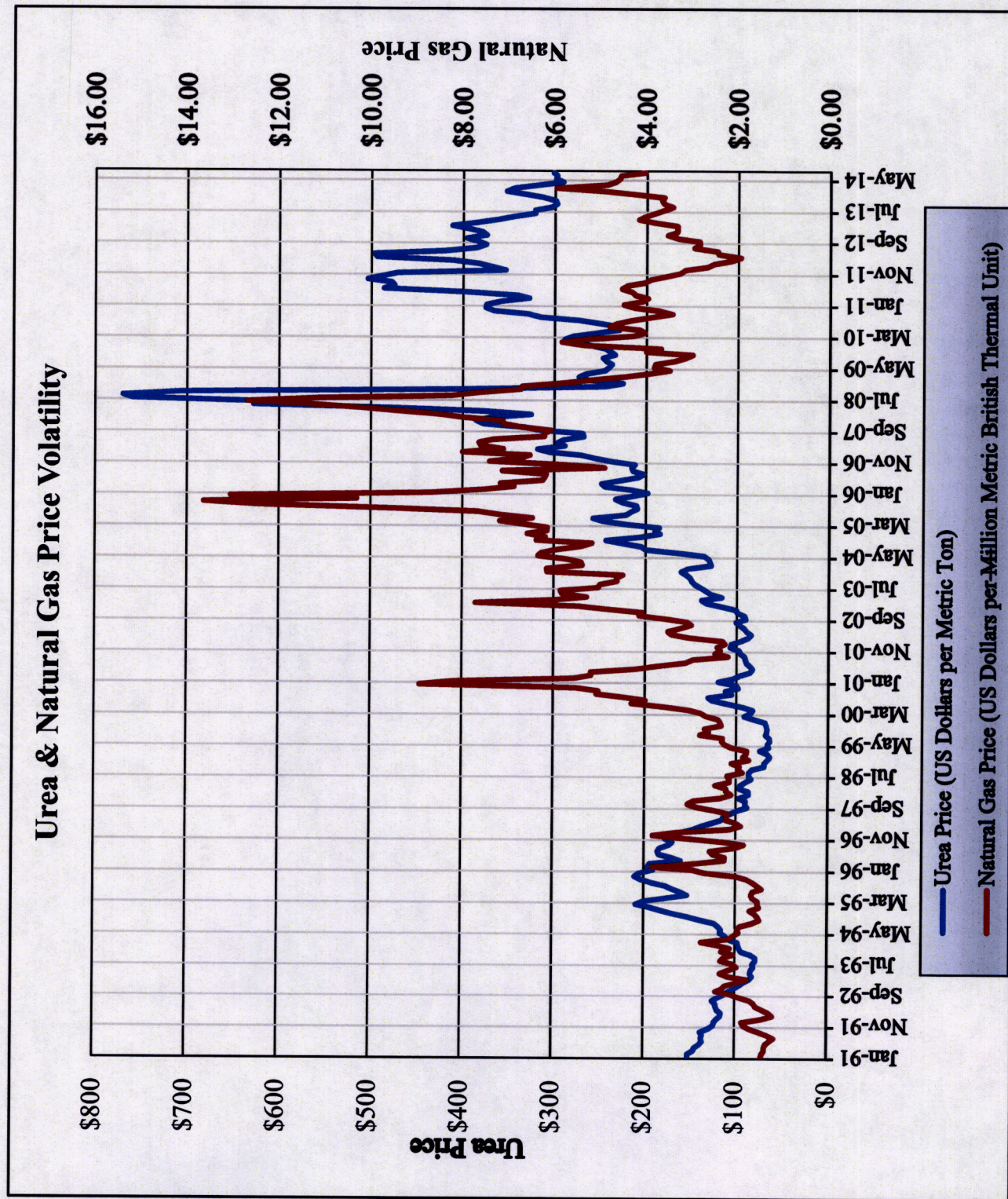


EXHIBIT 2

ACTIVATED CARBON SUMMARY

1. US demand for activated carbon, including virgin and reactivated products sold by activated carbon suppliers, is expected to grow 11.2 percent per year to almost 1.3 billion pounds in 2017, with market value reaching almost \$1.8 billion. Implementation of the US Environmental Protection Agency's Mercury and Air Toxics Standards (MATS) will drive most of the growth, as utilities and industrial manufacturers upgrade their coal-fired power plants to comply with the regulations.¹
2. Global market for activated carbon was valued at USD 1,913.2 million in 2012 and is expected to reach USD 4,180.5 million by 2019, growing at a CAGR of 11.9% from 2013 to 2019. Air purification is expected to be the fastest growing market and is expected to grow at a CAGR of 13.9% from 2013 to 2019.²
3. North American demand for powdered activated carbon in mercury control applications, which grew at a dramatic 101% per year between 2007 and 2012, compared with an average overall growth rate for all applications of 13% per year. In October 2013, a new UN Treaty on mercury control will be signed that holds even greater potential for activated carbon consumption.³
4. Global market for Activated Carbon is projected to reach 1.87 million metric tons by 2018, driven by stringent environmental regulations, especially in the United States." The United States is forecast to emerge as the fastest growing market with a projected CAGR of 13.2% over the analysis period.⁴
5. The global market for activated carbon was estimated to be 1,254 kilo tons in 2012 and is expected to grow at a CAGR of 11.7% from 2014 to 2020.⁵

¹ Source: "Activated Carbon to 2017", Freedonia Group, May 2013.

² Source: "Activated Carbon Market – Global Industry Analysis, Size, Share, Growth, Trends and Forecast, 2013 – 2019", Transparency Market Research, August 2013.

³ Source: "Activated Carbon: Global Industry Markets & Outlook", Roskill Information Services Limited, March 2013.

⁴ Source: "Activated Carbon: A Global Strategic Business Report", Global Industry Analysts, Inc.

⁵ Source: "Activated Carbon Market Analysis and Segment Forecasts to 2020", Grand View Research, February 2014.